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C O N F I D E N T I A L CARACAS 000610

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SUBJECT: IMF REP SEES LITTLE TO CHEER ABOUT IN VENEZUELA'S ECONOMY

REF: CARACAS 03/4011

Classified By: Economic Counselor Richard M. Sanders

Summary

1. (C) In a February 19 meeting with Econcouns, IMF Resident Representative Humberto Arbulu expressed deep skepticism over Chavez administration economic policies and frustration over the lack of transparency in economic information made available to him. He gave the Finance Ministry high marks for its borrowing activities, while seeing the Central Bank as vulnerable to Chavez's attacks. He was appalled at the Planning Ministry's preoccupations with food self-sufficiency, and believed that PDVSA was keeping large amounts of money off-shore. His medium-term prediction for Venezuela was "steady decline," rather than a big crash, a view with which we concur. End summary.

The Borrowing Machine Rolls On

2. (C) Arbulu suggested that within ten days, the GOV would issue its long expected bond issue which would roll over existing internal debt into a mixture of foreign and domestic obligations with longer maturities. (Note: Finance Minister Nobrega told the Ambassador on February 6 that the issue could be for as much as USD 3 billion dollars.) Arbulu predicted that savings in loan amortizations could be as much as USD 1.5 billion over time. This would all, he predicted, be ploughed back into current spending by the GOV. He confirmed that like previous issues, this one would entail the immediate exchangeability of purchased bonds for dollars at the official rate (see ref tel for further details on this mechanism). This has the effect of making such bonds "a killing" for purchasers, noted Arbulu.

Financial Wizardry, Amidst Continued Economic Doldrums

3. (C) The successful bond swap means that the GOV will be able to maintain fiscal equilibrium avoiding a painful adjustment "at least until October or even December," in Arbulu's view, assuming that world oil prices do not drop significantly. This would, however, entail renewal of the .05 pct tax on financial transactions, which is due to expire. Arbulu also suggested that once it got past the current political season, the Finance Ministry would be looking at revenue enhancement measures. (Note: Finmin Nobrega has spoken on occasion of extending value-added tax to a wider range of products. End note.) While the GOV may have covered its financial flanks, and thus can avoid a crisis, it would not, he suggested, be able to achieve robust, job-creating growth, because Venezuela's private sector does not face conditions favorable to investment. His overall medium-term economic prediction was "slow, steady decline."

Tension Among Economic Decision-Makers

4. (C) Arbulu, whose office is located at the Central Bank headquarters, painted a portrait of a government bureaucracy racked by suspicion and confusion. The Central Bank was under great pressure, following Chavez's public attacks on it. His own access at the Bank was diminishing, as once easily obtained information becomes less available. Chavez's repeated, public demonization of the IMF was, he concluded, making Central Bank officials increasingly less willing to talk to him. The Finance Ministry remained a somewhat more normal environment, he suggested, although Nobrega has been weakened by Chavez's evident intention to maintain a single exchange rate, rather than go to a dual rate system. He saw the departure of Banking Superintendent Irwing Ochoa, a U.S.-trained technician and a close Nobrega associate, as a

precursor to Nobrega's own departure.

Bizarre Meeting at Planning Ministry

15. (C) A recent meeting at another key player in economic policy-making, the Planning Ministry, had been a "disaster," according to Arbulu. He had sought a meeting with members of Minister Luis Giordani's team for several months with the purpose of trying to understand the sources of funding for the various GOV "missions" in health, education, and job creation and the purposes to which they were being put. The Planning Ministry officials danced around his questions, and ultimately it became obvious that they did not have any clear understanding themselves. Ministry officials, however, did devote considerable energy to defending GOV supposed initiatives to revitalize domestic agricultural production. This was crucial, they asserted because Venezuela was import-dependent now, and "a foreign power" could blockade the country's main ports, reducing it to starvation.

The PDVSA Mystery

16. (C) Arbulu said that by his calculations in 2003 state oil corporation PDVSA earned more than USD 2 billion than it reported to the Central Bank. This very large sum was presumably being kept in off-shore accounts. Arbulu suggested that a considerable amount of the funding which the various GOV social spending programs were receiving was in fact coming off the books from PDVSA. Amounts earned by private individuals in exchanging this money, which would not go through the Foreign Exchange Control Commission (CADIVI), were, he further speculated, likely to be enormous.

Comment

17. (C) Arbulu's picture of turbulence and lack of transparency at GOV economic institutions tracks what we hear from other sources. The combination of ideology, improvisation, corruption and short-term politicking that affects economic decision-making is not likely to change while Chavez is in office. Successful borrowing operations, both externally and internally, mean that a financial crash is unlikely. But political tension, growth-smothering exchange controls, and lack of attention to the fundamentals mean that the modest recovery we are seeing right now after two dreadful years is unlikely to be sustainable. Arbulu's prediction of further decay over the medium term seems right on the money to us.

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